RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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March 6, 1991 **LETTER 1064**

Feb. 22 DJIA 2889.36; PTI 3201; A-D Ratio -13.00
Mar. 1 DJIA 2909.90; PTI 3212; A-D Ratio -12.52
Dow Yield: 3.45%; Dow P/E: 16.7; DowPow: -99
Dow 200-day MA: 2689; Dow 30-day MA: 2785
Dow Book Value: 1276; PTI 89-day MA: 3167
Percentage of Undervalued Blue-chips: 16%

STATISTICS: The bullish hint near the January lows (just before the market's upward explosion) was a marked contraction of new lows on the NYSE even as the Dow sank lower.

Now we've seen the equal but opposite reaction -- a contraction of new highs even as the Dow pushes higher. Consider these figures:

Feb. 11 -- Dow: 2902.23, daily new highs: 205
Feb. 13 -- Dow: 2909.16, daily new highs: 130
Feb. 15 -- Dow: 2934.65, daily new highs: 97

Feb. 25 -- Saddam gives order for his soldiers to get out of Kuwait. Feb. 27 -- Bush declares a cease fire.

Feb. 27 -- The CRB Commodity chart service's Stock Market Momentum Indicator is at an historic overbought high and moving steadily toward what should be an important sell signal.

However, my Primary Trend Index (PTI -- see page 2 chart) is now 45 points above its moving average and it therefore remains in the bullish mode. The PTI is my fail-safe indicator. Every major market rise occurs with the PTI above its moving average, every major decline takes place with the PTI below its MA. A penetration above or below the MA cannot tell us the potential extent or duration of the move.

From a Dow Theory standpoint, the current market situation is most interesting. The weekly chart on this page (courtesy of *Mansfield*) shows the big picture. Here we see the Dow within easy shooting distance of its 1990 record high of 2999.75. At the same time the Transportation Average has been tracing out a series of declining tops. Thus, a massive area of non-confirmations has been formed (and strangely, almost no one is taking notice of this). So as I see it, the final history of the 1987-91 market is still to be written.

The nation has been (is) in recession, and there have been hints of that dreaded phenomenon -- deflation. The US economy can survive debt up to a point, it can survive war, it can survive a slowdown, but there's one thing it cannot survive (at least in its present form), and that's deflation.

Why, what's wrong with deflation? Deflation crushes debt. In fact, the formula (as every S&L and bank knows) is this: debt + deflation = bankruptcy. The Fed is keenly aware of the above formula. The Fed also knows that the total private and public debt in the US amounts to around $13 trillion. All of that debt has to be carried; all of that debt must throw off interest. And interest is a lot easier to generate when the dollar is worth less and less.

Thus, this nation has a vested interest in inflation. Debt and Inflation have become the life blood of the US.

Therefore, it should come as no surprise that the Fed's been fighting the recession and deflation with all the weapons at its command -- lower discount rates, lower fed funds, lower bank reserves. The Fed is trying mightily to reliquefy the economy. To put it bluntly, the Fed wants to re-inflate.

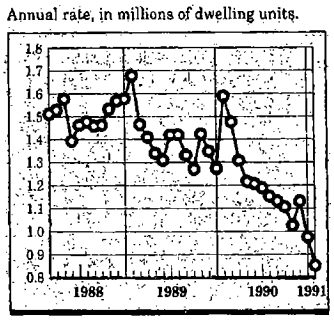
The January-February market explosion could be the market's way of saying that it believes the Fed will be successful. The stock market seems to be saying that the Fed's re-inflation medicine has always worked in the past, and that it will work again now.

But there are a few current items which are either confusing the Fed or which are unprecedented. (1) The war was a wild card for the Fed, as Mr. Greenspan keeps saying. (2) The current recession is the first since World War II in which interest rates were already falling. (3) Despite move after move, the Fed has been unable to counteract the chronic scarcity of credit. (4) The US federal debt continues to spiral out of control. (5) For the first time in memory, the government has no fiscal policy with which to deal with tough economic times.

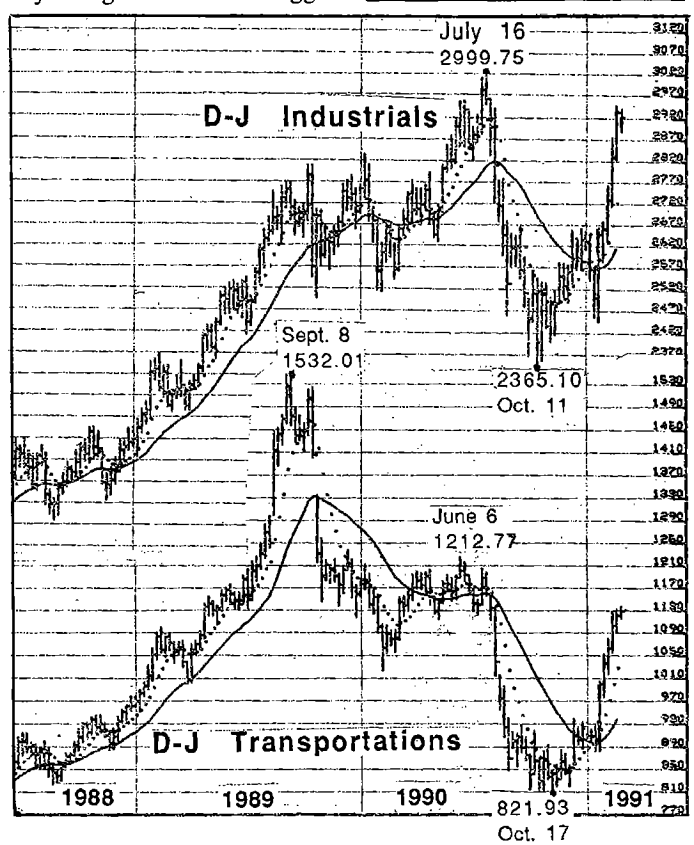
Mr. Greenspan is visibly confused. Recently he stated, "The current outlook is unusually clouded". . . "This divergence in opinion has its roots in the major uncertainties facing all forecasters today."

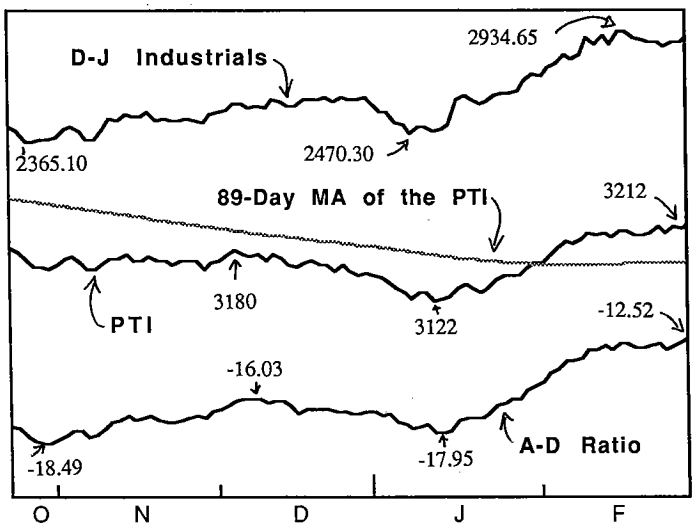
Housing Starts

Annual rate, in millions of dwelling units.



In the meantime, the big question is -- will the Fed's "inflation injections" work? Will they reverse what we see in the housing chart at right? Will they revive collapsing auto sales? Will they bring new life to sluggish





retail sales? Or will deflation and a stubborn and fearful public win out? Stay tuned.

THE MARKET PICTURE: The big story, aside from the spectacular advance in the Averages, is the so-called "breadth thrust," which was signalled on February 11. Simply stated, this is a rise in the market which is strong enough to produce a ratio of 2-to-1 or better on the 10-day moving average of advances-to-declines. The breadth thrust has suddenly received wide publicity, but probably the most serious and important treatment of it was given first by Marty Zweig two weeks ago in *Barron's* and then by Ned Davis in the February 18 issue of *Barron's*.

The theory behind the breadth thrust is as follows: the breadth thrust requires a number of days of outstanding upside breadth (10 to 12 days or more) in order to materialize. In the past when this kind of concentrated buying appeared, it was an indication that large and important interests were pouring money into the market. This type of massive buying has almost always been associated with a further rise in the Averages and the market. In such instances, the worst case was that the market was "safe" for at least three to six months after the breadth thrust, sometimes more. In other words, the market was comparatively safe on the downside but open-ended on the upside.

So the obvious question is, "Will this bullish sequence occur again?" All market analysis boils down to probabilities. And, of course, probabilities suggest that the February breadth thrust will be followed by the same kind of action that previous breadth-thrusts have enjoyed -- to wit, higher prices.

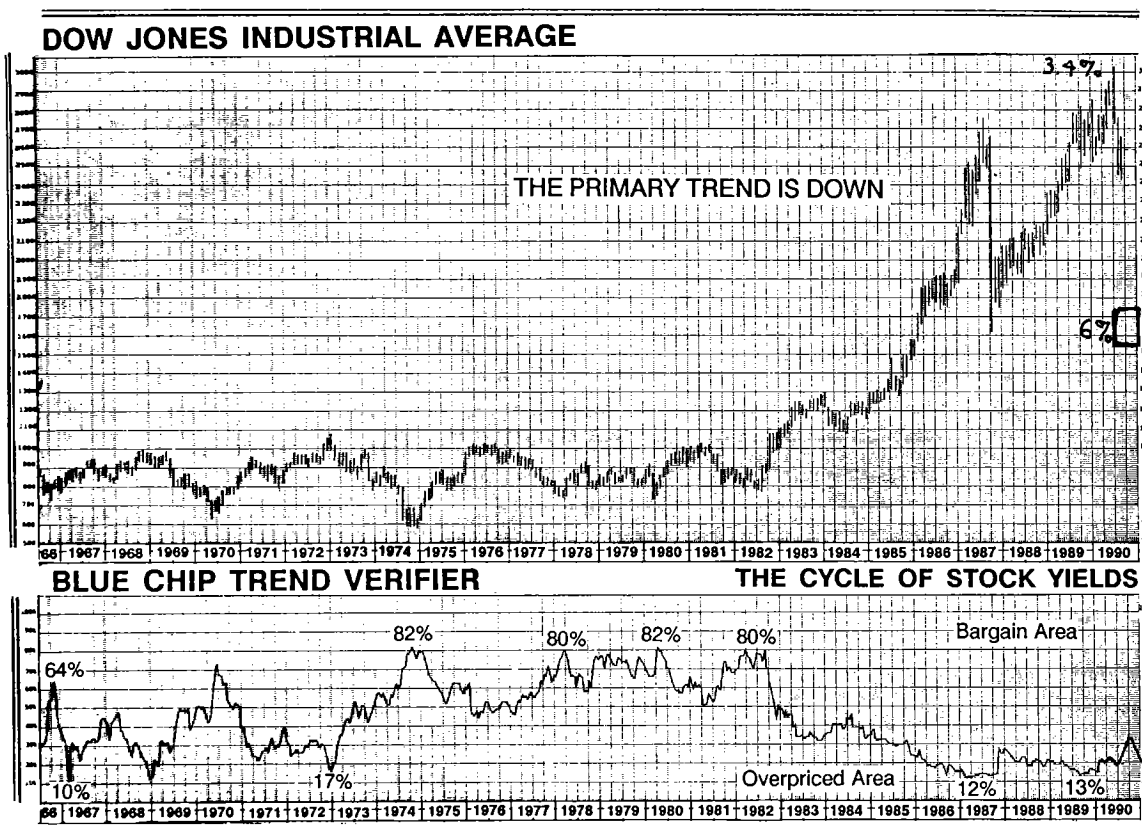
Yet a few items bother me here. The first is the wide publicity given to the recent breadth thrust. Suddenly, every analyst and every market letter is talking about "the thrust." Suddenly, everybody is talking about "the new bull market." Suddenly, everyone is a true believer in technical analysis, and certainly the whole breadth thrust concept is a child of technical analysis.

The second thing that bothers me is this: the rise which started at last year's October low did not stem from a classically oversold market bottom. In other words, even those who bought at the very bottom were not buying undervalued stocks. Most great advances (i.e., 1974 or 1982 or even 1984) start from areas where stocks were (a) oversold and (b) where stocks represented outstanding values based on dividend yield.

Many analysts are saying that new Dow highs and perhaps a further rise of 200 to 300 points are to be expected from here. However, I note that based on dividends of 100.25, the Dow is now selling at slightly over 29 times dividends. This puts the Dow within the area of major tops. It means that any rise from here simply places currently overvalued stocks in the category of "still more overvalued."

On the much broader S&P 500 Composite, the story is the same. Dividends on the 500 are at 12.25. At the current price of around 369, the S&P 500 is selling at 30.1 times dividends. So the S&P 500 is also in the area of tops. Rallies from here will make already expensive shares even more expensive.

Perhaps the whole situation can best be seen in the chart on page 2, a chart published by *Investment Quality Trends* of La Jolla. *IQ Trends* monitors 350 blue-chip stocks (all on the NYSE) in terms of their dividend yields. Historically, each stock has a yield range or band. For instance, in their current issue *IQ Trends* shows a chart of Thomas & Betts with its yield band. The chart shows that historically Thomas & Betts is undervalued when it yields 4%, and overvalued when it yields only 2%.



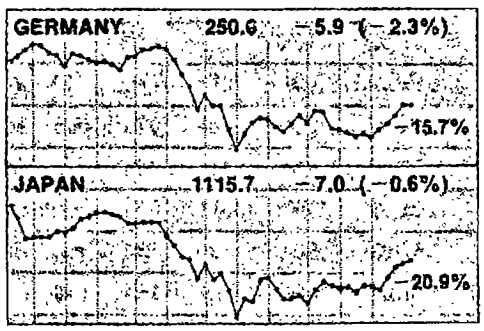
So each month *IQ Trends* tabulates the percentage of stocks that are undervalued. The latest tabulation shows that the percentage of undervalued stocks has dropped to a thin 16%. Note on the chart that this is actually one percent below the 17% that identified the extreme market top in January 1973. That 17% figure appeared just prior to the worst bear market since the 1930s.

What I am trying to show is that the current stock market, even in the face of the breadth thrust, has

now moved into overvalued territory. If one buys stocks here, one is buying on the basis of the breadth thrust, rather than on the basis of values.

But as I have stated so many times before, the most important single consideration in Dow Theory concerns buying when stocks represent great values. Stocks in the current area aren't even good values, they are overvalued based on their dividend yield.

Another unusual factor in this market is that the two big overseas markets, the German and Japanese, did not show anything like the strength exhibited by the US market. This is most unusual since both the Japan and Germany economies are considerably stronger economies than ours.



WHAT IS IT? There is also much debate at present as to what this market rise represents. Is it a new bull market? Is it a continuation of the old bull market? Or is it another bear market thrust into overvalued territory -- and the further extension of a huge, literally unprecedented top?

Here are my thoughts. First, it is not a new bull market. No bull market ever started from a Dow selling at 12 times earnings and a dividend yield of 4.17%, or at a Dow selling at better than twice book value. Yet those are the statistics which accompanied the lows of last October.

Second, I don't think we're seeing a continuation of the old bull market. As outlined in the last Letter, the market action during 1987 to 1989 produced every characteristic of a major bull market top. In fact, it was a picture-perfect top.

Third, my feeling is that what we are seeing now is the extension of an unprecedented bear market top, a top that began with the market crash of October 1987, was "confirmed" by the lesser crash of 1989 and was again confirmed by the breadth crash of July to October 1990.

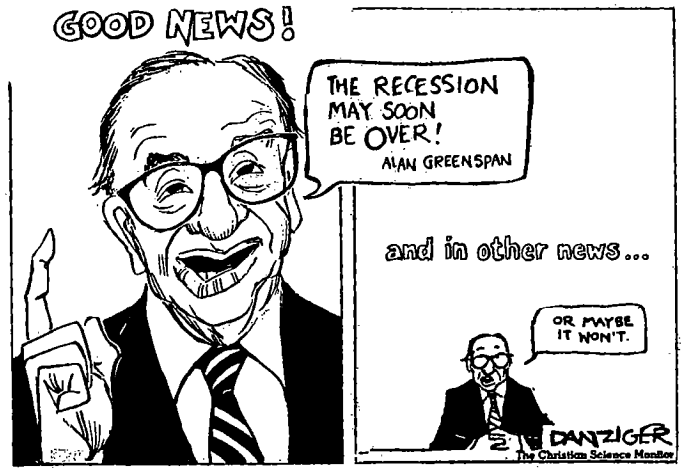
What I believe is happening is this: when the Fed realized that it had erred and that the US economy was in a virtual nosedive, the Fed panicked. It pulled out all the stops. Fed funds were dropped, bank reserves were lowered and the discount rate was racheted down twice. The stock market, based on past case histories and performance, took the Fed action as "The Signal." Suddenly the institutions rushed to get into stocks and out of cash. In fact, it was a race to get out of cash. In the face of the sudden turn-around, the short sellers were terrified, and they raced to cover as their losses mounted.

All of this occurred in the face of a recession and the beginning of war. Thus, market sages could announce that the stock market was indeed climbing the proverbial wall of worry. As the rally progressed, analysts announced that the stock market was forecasting an early end to the war and an early end to what might even be a mild recession. And on February 20, Fed Chairman Greenspan went so far as to announce before the Senate Banking Committee that the recession was almost over.

Greenspan Now Says Recession Is Almost Over

By JAMES RISEN
TIMES STAFF WRITER

WASHINGTON—Federal Reserve Board Chairman Alan Greenspan on Wednesday returned to a more upbeat assessment of the economy after a brief spell of pessimism, predicting that the recession will end soon and that inflation



And that's where we find ourselves today.

DEBTS: I continue to believe that this bear market will be seen historically as a function of debt. Consider this: the latest reading shows that the total federal debt stands at $3.4583 trillion. Exactly one year ago the total debt was $2.9945 trillion. This means that over the last 12 months the US has added a new record **$463.8 billion** to the total federal debt. This amounts to rising deficits at the record rate of $1.27 billion A DAY. Incredible! And dangerous.

In the February 18 issue of *Barron's* is an article entitled "Are Bonds Peaking?" by Morris Markovitz. He wrote, "The current market value of all US listed stocks is around $3 trillion, while the (annual) federal deficit is over $400 billion and rising rapidly. If current trends persist, this would mean that over the next six years or so, the federal government would be asking the economy to lend it, in real terms, an amount equal to the entire wealth that all listed stocks in America have accumulated since time immemorial. This is impossible.

"Something's got to give. Either government spending will have to be cut to the bone immediately or (more likely given the history of US politics and politicians) there will be a truly staggering debt-repudiation via printing-press inflation. Either way, higher interest rates -- and tough times for bonds -- are coming. The Nineties could make the Eighties -- crashes and all -- look like the good old days."

Two things -- first, it's gratifying to know that someone besides me is noticing that "over 400 billion" a year is being added to the federal debt. Second -- Markovitz's paragraphs sound like the scenario for perhaps the greatest bear market in US history. Question -- could this fantastic three-and-a-half year bear market top be preparing the market for the scenario that Markovitz envisions? It just could be.

Over the weekend I received the latest report from Dr. Kurt Richebacher of Frankfurt, Germany. Dr. Richebacher takes a dim view of what is happening in the so-called Anglo Saxon nations. Here are some excerpts: "Over-indebted consumers and corporations are not so much starving for credit as they are being strangled by illiquidity caused by previous debt excesses. During the third quarter of 1990, US GNP grew a nominal $77 billion while overall debt grew $177 billion, more than two times as much. This credit/GNP ratio is the sign of an economy that is illiquid and increasingly illiquefying, not reliquefying itself.

"What is the cause of lower inflation, falling costs or falling profits? The answer is plainly obvious to anyone who cares to see. The fact is that there is an intensifying squeeze on already-low profits. Unfortunately, in the Anglo Saxon countries, it is overwhelmingly the latter cause, namely, an intensifying profit squeeze. That is not the recipe for recovery, but rather for a deepening recession"(courtesy *Currencies and Credit Markets*, Mulberry Press, Inc., 7889 Sixteen Rd., Calstor Center, Ontario Canada LOR 1EO).

Note: according to the Feb. 28 *WSJ*, the public has been pouring into the market via mutual funds, and the special target of the public

are the funds dealing in secondary stocks. Will the public be right? They usually aren't.

INVESTMENT POSITION: The dollar has turned strong, and I think at this point dollars are the best place to be -- T-bills preferred, but government money market funds are also all right. This mean that those in the currencies should hedge with futures contracts against taking losses in the face of the strong dollar. Hedging can be done at the banks where you bought the currencies.

Why the strong dollar? One reason (aside from the fact that the dollar got oversold) is that massive amounts of new money will be needed to rebuild Kuwait (yeah, and Iraq, too). That will entail a large demand for dollars, and corporations worldwide are already lined up to bid for the rebuilding contracts. What's the saying? "Need money? No problem, just lose a war to the US."

The stock market is now plainly in the overvalued zone. When you buy stocks here, you're buying them in the hope of selling them to the proverbial "greater fool."

Bonds have topped out, and the June T-bond contract is now well below the peak it hit last December.

Gold has been moving up, and I continue to feel that gold under 400 is good value and gold under 375 is very good value. Watch the April gold contract. It has to hit 375 for the first signal of a real bullish reversal.

The bear remains in the box, and I suggest you study the page 1 chart of the Averages carefully.

NOTES & QUOTES: Now that the war's about over, skeptical observers are wondering how much cash our allies are going to come up with. Richard Darman, Director of the Office of Management and Budget, admitted last week that of the $53.5 billion that has been pledged to the US for war expenses, only $14.9 billion has come in so far. Biggest doubts center around Japan, where politically it's going to be difficult to vote the money.

* *

They're talking about reparations from Iraq. My comment -- dream on. My question: who's going to pay for the food and upkeep for the 80,000 plus Iraqi prisoners of war?

* *

There are many theories on exactly why we had a war, and many of the theories revolve around the psyche and personality of George Bush. One theory is that Bush was still fighting the "wimp" label, and he felt that to be passive in the face of Saddam's aggression would re-label him a super-wimp.

A second theory is that Bush takes matters very personally. And just as he felt Noriega had gone too far, crossed a line that he should not have crossed, Bush felt that Saddam had done the same. Crossing that line, Bush believed, was almost a personal affront, and it led to no other course but war. On top of this, Bush firmly believes that his course was God's course -- that fighting Saddam was the right thing, the only moral thing to do.

A third theory was put forth by Bill Mauldin, the great cartoonist and friend of the GIs during World War II (Mauldin is now drawing cartoons for the "grunts" of the Persian Gulf). In a recent interview, Mauldin stated, "Frankly, I think all wars are alike. Some wars I approve of and, although I'm not a pacifist, some wars I do not approve of. And I most emphatically do not approve of this one. The oil connection is obvious. The Bush connection to oil is obvious. Good God, he's an old wildcatter from Midland, Texas. There's a connection somewhere . . . I've been very rough on Bush throughout this thing."

Speaking of Bush and oil, his "new" energy policy has been called simply a cave-in to oil interests. The policy has been described as "drill, drill, drill, waste, waste, waste."

But again, there's no hero like a war hero, and Bush's "approval rating" at latest count is an unprecedented 91%. America loves Bush. And "Stormin' Norman" Schwarzkopf can name his job. Private industry is drooling to get him.

* *

A new, massive market for consumer and industrial products will emerge in the 1990s in South Korea, Singapore, Hong Kong, Taiwan, Thailand, Indonesia and Malaysia. And Japanese investments in these nations signify that Japan will be in the best position to gain from the growth of the Asian nations. It is also felt that the US is lagging far behind in recognizing the booming growth potential in these Asian nations. Ponder this: in 1989, 90 new, modern Japanese factories opened in Thailand -- one factory every four days. And from January through September of 1990, 110 factories opened -- or two every five days . . . Hong Kong and the neighboring Chinese province of Guangdong have attracted so many foreign factories that one bank economist predicted that by the year 2000 the "Hong Kong enclave" alone will have a GNP as big as France.

However, the Japanese boom seems to be simmering down. The boom was originally fueled by wild prices in Japanese real estate. Prices for real estate have softened, and interest rates have risen to where companies now have to pay 8% or more for new money. Furthermore, the massive Japanese trade surpluses are now easing off.

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European economies have been soft with many in or near recession (Britain is in a severe recession). This clip from *Investor's Daily* (Feb. 28) tells the story.

European Slump May Be Deeper And Last Longer Than Expected

PARIS (Reuter) — Evidence is mounting that the European industrial downturn is deeper than first thought and may not be easily reversed by a swift end to the Gulf war.

Even if companies resuscitate investment plans and consumers start spending, inventories.

Italian industry wants government help, such as easier credit for small firms and tax breaks for investment, to ease the pain caused by higher wage costs and slowing global growth. It plans to present its proposals to the government

* *

To the chagrin of US and European competitors, Japan's high-technology giants are readying a new generation of powerful computer chips. About the size of a thumbnail, the new chips are 16 times more powerful than the largest chips now in commercial use. Each chip will hold as much information as contained in 250 pages of newspapers. As far as is known, only IBM is preparing a chip which may compete with the new Japanese chip.

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The housing and automobile industry comprise roughly 50% of the US Gross National Product. Both of these industries are now in severe slumps with no hint yet of any upturn. The Fed, turning to easy money, expects that both of these industries will re-ignite. But it occurs to me that there are cycles of human emotion, and it is just possible that this is one of those cycles when people are pessimistic and are in no mood to buy, regardless of the price of credit. A poll of real estate executives (see *WSJ*, Feb. 20) shows that "72% predicted that it will take two to five years for their industry to come out of a deep and sustained downturn . . . The building industry is considered a linchpin of the economy, having led the way out of every recession since WW II. Construction is so depressed, however, that some economists say that it promises to act as a drag on the economy for many more months." The latest figures show housing starts in January down 12.8%.

* *

Headlines the February 18 issue of *Automotive News:* "Toyota's Entry Means War in the Big Pickup Field. It's the Big 3 profits stronghold." GM, Ford and Chrysler depend on the big profits in the big pickup truck field. But Toyota is planning to move into that chosen field, probably around the mid-1990s. The full-sized pickup is considered to be the single most important vehicle in GM's and Ford's product line.

* *

Do the Arabs have money? Well, on one hand we see the remarkable sight of Saudi Arabia actually borrowing -- they just floated out a bond issue of $3.6 billion. Wars just don't come cheap. On the other hand, consider this. David Geffin is considered the richest man in Hollywood -- he just collected $710 million on the MCA buyout. But last week one Arabia prince put up $590 million as in investment in Citicorp. And that's just one Arabian prince. There are hundreds of them.

* *

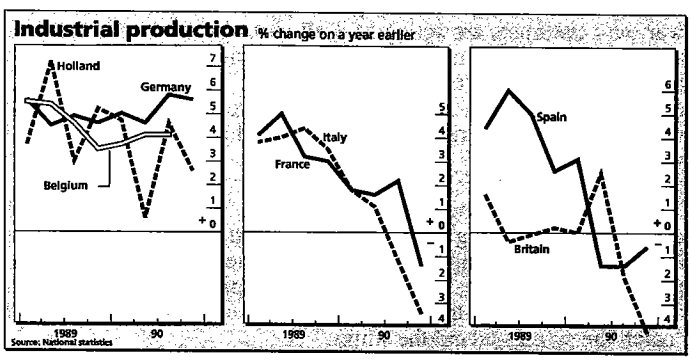
All the world is fascinated with the other guy's tragedy, especially if "the other guy" is a name player or a celebrity. Right now Hollywood is watching Italian "financier" Giancarlo Perretti, new owner of MGM/Pathe. Who is he really and does he have any money? The feeling is that the wolf is at his door . . . Sadder are the cases of sports stars who have gone broke. Latest is NFL great Johnny Unitas who is reputed to be bankrupt. And Steve Garvey recently stated the same. Last year it was tennis star Bjorn Borg who went broke. Most sports stars either spend it all too soon, make bad investments or get taken by stupid or unscrupulous managers. Moral: when you're making big bucks, don't let it go to your head. Let it go into savings instead.

* *

A San Diego restaurant chain has come up with a novel idea to bring customers in. Big street signs advertise to bring in the kids "at a penny a pound." In other words, if your kid weighs 80 pounds he gets a full meal at the restaurant for 80 cents. Not bad.

* *

One unusual facet of the current stock market is that the foreign markets have not done nearly as well as the US market. In the past, for instance, Japan led the US. But that's not happening now. And it's not happening in Germany, which boasts the strongest economy in Europe. Is Wall Street off into space on its own? We'll find out in time. This chart from the *Economist* shows the year-to-year comparisons of various nations' GNP. Note that only Germany is holding up. The US recession could be spreading to the rest of the world.



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Speaking of my favorite magazine, the *Economist*, guess what? The authoritative Adweek listed their "10 hottest magazines of 1990." They are (1) *Parenting*, (2) *Conde Nast's Traveler*, (3) *Victoria*, and (4) would you believe, the *Economist*.

* *

President Bush seeks advice from only one ex-president. That ex-President is Richard Nixon. Six months ago Nixon wrote Bush a long letter that Bush feels was prescient. Nixon told Bush that Gorbachev was a shaky leader, that he was veering away from democracy, and that he was subject to tremendous pressures from the right. After Iraq invaded Kuwait, Bush called Nixon and was told to "move strongly and decisively" and argued that the crisis represented "a defining moment in history; it's important for the world." Nixon said that the US, as the world's only remaining super-power, needed to show that it can act decisively to stop aggression and preserve its vital interests.

* *

The Janeway View: The following is from my old friend Eliot Janeway, who knows a thing or two about the way economies and markets work: "The markets are convinced that lower interest rates cure recessions. But a shock is about to jolt them: the drop in rates isn't turning the economy back on. As fast as institutions have rushed to buy stocks for fear of missing the boat, the foreign Central Banks have rushed to buy the dollar to protect their enormous stake in it. On capital account, all of them carry most of their reserves in dollars. On current account, all other countries are export-dependent and replenish their dollar balances by collecting the bulk of their foreign earnings in dollars. Consequently, all of them are running scared of a forced dollar devaluation, which would cost them a dollar." Russell comment: In other words, the Central Banks are scared to death of a big plunge in the dollar, and consequently they have been supporting the greenback.

* *

Michael Milken will be going to prison for ten years with a possible revised reduction to three years. The *LA Times* (Feb. 23) put it a different way on its business page headlines: "Milken Faces Pay Cut of $107,000 an Hour at Federal Prison Camp." The article noted, however, that "the nation's best-known white collar criminal" will have "a far shorter work day" (Milken used to work 14 to 18 hours a day while making multi-millions in his operations as America's junk bond king).

* *

Nelson's Earnings Outlook is widely followed by industry. *Nelson's* states that during the latest month Wall Street investment firms lowered 1992 earnings estimates on more than 40% of 2,900 firms surveyed. On the other hand, they raised their estimates on only 17% of those 2,900 firms. If Wall Street's estimates are accurate, this is not going to be an easy recession to get out of.

* *

The disastrous five-year drought in California is exacerbating an already rough situation. Some communities are now banning the building of new houses since new customers mean more need for water. San Diego is facing a possible 50% cut in water, and I'm telling my friends to say good bye to their lawns and their daily baths (it's going to be short showers from now on).

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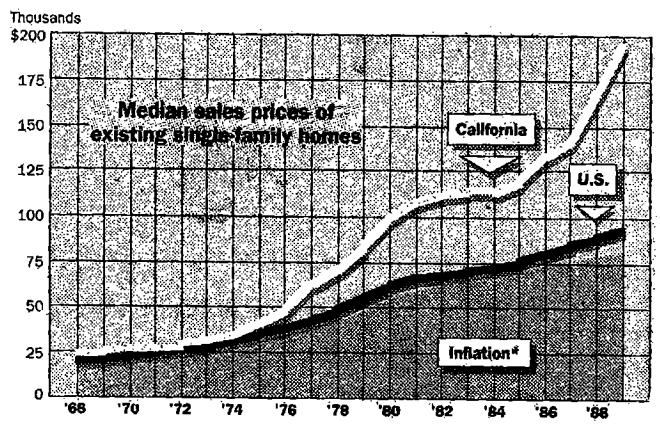
This chart shows the US inflation rate since 1968 plus the median price of a US house. As you can see, the median home price has done better than the inflation rate. Now look at the median price of a California home. It's almost off the chart. Question -- with smog, a severe drought, crowded highways, high state taxes, high home prices, and a high unemployment rate, is California still the Golden State? And if not, are California home prices due to correct (i.e., come down)? Home prices are already down 10 to 15% and some luxury developments are being advertised from $75,000 to $150,000 below original sales price. For years (decades), Coast real estate has outperformed most of the rest of the nation's real estate. And I wonder if California real estate isn't ready for a big downside correction.



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Where is the wealth of the typical American? Here's the breakdown -- 23.2% is in their homes, 16.1% is in savings, 14.3% is in pensions, 12.2% is in stocks or mutual funds, 9.2% is in bonds and the rest is scattered in miscellaneous items.

* *

You know those extra warranties that they try to sell you every time you buy an appliance? Those two- and three-year extension warranties are big money makers for the seller. So the word is -- skip 'em. Studies show that in most cases only around 4% of the extension warranties are ever used. Thus the extra two and three extensions represent pure gravy for the stores.

GOLD: On February 22 gold suddenly dropped under 360, to the fear and consternation of all gold-philes. Gold shorts increased, puts were bought, and gold contracts were dumped. But gold held below 360 for only three days and then began to climb. By March 1 spot gold had recovered to 366.90 and the gold stock group had surged in relative strength against other groups.

Last week platinum, gold's companion, climbed over 400 amid rumors of heavy Japanese buying. But it's still not clear what's happening in the closely-scrutinized gold market. This chart (courtesy of *CRB*) will at least provide some perspective on gold.

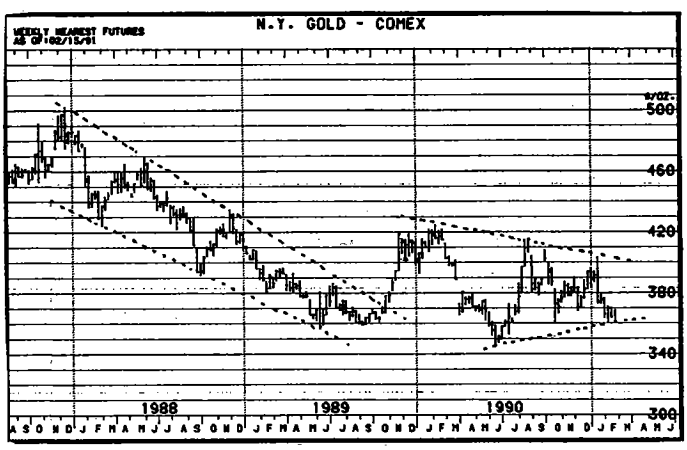
During 1988 and most of 1989 the trend of gold was clearly down. Gold was traveling within a descending channel. In October 1989 gold broke out of the channel to the upside, then rallied to the 420 level. Gold-philes were ecstatic. But their enthusiasm was short-lived. During 1990 gold plunged to the 346 level. Despondency again reigned.

But in the third quarter of 1990 gold advanced to 417, then dropped back. A new pattern formed, and it was one of indecision. I have drawn the boundaries of a very large triangle. The breakout points are 400 on the upside and 360 on the downside.

A more conservative way of looking at it is to say that since 1990 gold has been in a 75-point trading range with the top at 420 and a bottom at 346.

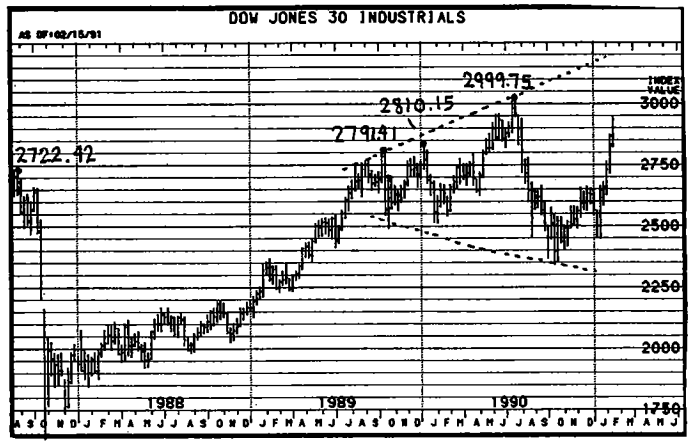
One thing is clear -- at roughly 350 broad support comes in for gold. Whether this support stems from central banks or whether it comes from large investors is not clear (probably both), but the world seems to think that gold around the 350 level is a bargain. As far as the periodic selling is concerned, it is thought that both Iraq (which stole all of Kuwait's gold) and Russia (which is bankrupt) have been selling gold in large quantities on the world market in order to raise hard currency.

History tells us that nations that sell their gold are nations that are declining in power. In the case of Iraq and Russia, who can argue with that assessment? Interestingly, the gold coffers of Asia have been expanding, with Taiwan a major buyer of gold. Taiwan, I might add, is a booming nation with (incredibly) one of the largest hoards of foreign currency of any nation on earth.



LATE NOTES: Charles Dow wrote that when stocks on average yield 3.5% or less, they are overvalued. Going back over stock market history, it is amazing how well Dow's original observations have withstood the test of time. The latest statistics show the Dow yielding 3.45% and selling at a fat 2.28 times book value. Furthermore, only a thin 16% of blue-chips are now undervalued. This market is expensive. It's a high-risk affair.

This chart (courtesy *Commodity Research Bureau*) shows the Dow weekly going back to late-1987. One way of interpreting what we see here is that the Dow since 1987 has had four distinct thrusts into the overvalued zone with a fifth thrust now underway.



In 1987 (just before the crash) the Dow surged to 2722.42, at which time the Dow yielded a minute 2.75%. In 1989 the Dow pushed to 2791.91, and again it fell back. In January 1990 the Dow advanced to 2910.15, then retreated. And in July 1990 the Dow advanced to a record 2999.75, then plunged to 2365.10 in October.

Following its July to October retreat, the Dow has again headed to the 2900-3000 zone. And again raging bulls are predicting Dow 3500 and 4000. Market sentiment has swung wildly from gloom and depression only a month ago to wide-spread optimism and the general consensus has it that "a new bull market is in force."

At this point Wall Street opinion seems to be calling for a period of consolidation and then another upward leg. The leg following the consolidation is to be the one that probes the Dow 3500-4000 area.

There is no question but the war brought on a good deal of the pessimism. But it also disguised the underlying problems of the recession. Meanwhile, money piled up on the sidelines. With the war over optimists are acting as if all recession problems are over and only blue skies lie ahead. Massive amounts of money have been pouring into the market, and the the war gloom has evaporated and been replaced by widespread euphoria over the boldness and prescience of Mr. Bush and his admittedly brilliant war generals.

The pattern we see on this chart is of the "funnel" variety, also called the "broadening top." This type of pattern is characteristic of areas of wide-swinging emotions -- pessimism, optimism, pessimism, optimism. Such swings can be profitable, but they can also be tricky and dangerous. For traders it becomes a problem of "catch the swings, avoid the stings."

Meanwhile, the bond market appears increasingly toppy. My bond market oscillator (*McClellan*, based on advances and declines on the NYSE bond market) gave a sell signal on February 26. The bellwether Treasury 7 7/8% bond of 2021 is now down over three points from its high, and its yield has risen to 8.28% (the yield when issued was 7.98%).

One of the fears hitting the bond market is the cost of rebuilding Kuwait. The rebuilding will require tens of billions of dollars in new capital and financing.

With the Fed opening the monetary spigots, the bond market also fears that inflation will again enter the picture. Furthermore, the gold price run-up of the past few weeks does nothing to calm those fears. There's a stubborn core of inflation that seems to be ready to fire-up as soon as the Fed takes its foot off the monetary brake.

PARTING NOTE: A special welcome to our many new overseas subscribers. When I started these Letters in 1958, I had literally no foreign readers. Now overseas readers comprise around 18% of our list (and special thanks to David Fuller -- *Fuller Money*, London -- for bringing in many new European readers). These days, if you're not thinking globally, you're not thinking. The times are a'changing -- and fast.

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